OLR RESEARCH REPORT

May 25, 2012 2012-R-0200

PENSION PLAN TERMINATIONS

By: Lee R. Hansen, Legislative Analyst II

You asked for details regarding how a private sector pension plan can be terminated.

SUMMARY

According to the federal Pension Benefit Guaranty Corporation (PBGC), private sector defined benefit pension plans can be terminated through (1) standard termination, if the pension plan has enough money to pay all benefits owed to participants, (2) distress termination, if the employer is in financial distress, or (3) involuntary termination, if the PBGC must intervene to protect plan benefits.

The PBGC was created by the federal Employee Retirement Income Security Act of 1974 (ERISA) to protect the pensions of participants in private defined benefit pension plans. ERISA sets minimum standards for private pension plans, including standards for participation, vesting, benefit accrual, funding, and pension management responsibility. Under ERISA, most private defined benefit pension plans are required to obtain pension benefit insurance through PBGC. Additional information on pension plan termination can be found at http://www.pbgc.gov/prac/terminations.html

Sandra Norman-Eady, Director
Phone (860) 240-8400
FAX (860) 240-8881
http://www.cga.ct.gov/olr

Connecticut General Assembly
Office of Legislative Research

Room 5300
Legislative Office Building
Hartford, CT 06106-1591
Olr@cga.ct.gov

STANDARD TERMINATIONS

An employer can end its pension plan through a standard termination only after showing PBGC that the plan has enough assets to pay all the benefits it owes to plan participants. The plan must either purchase an annuity from an insurance company that will provide lifetime retirement benefits or, if the plan allows, issue a one-time lump sum payment that covers the entire benefit.

If proceeding with a standard termination, an employer must also, among other things:

1. submit a termination notice to PBGC, including certified data on the plan's assets and liabilities;

2. issue a Notice of Intent to Terminate to affected parties, at least 60 days, and no more than 90 days, before the proposed termination date;

3. send each plan participant a notice that includes the benefit the participant earned and the data used to calculate it;

4. inform plan participants of the insurer from whom an annuity is being purchased, or the name of insurers from whom bids will be sought, no later than 45 days before plan assets are distributed;

5. conduct a diligent search for any missing plan participants and, for any who cannot be located, provide PBGC with either the money to pay their benefits or the insurer holding their annuities; and

6. distribute the plan's assets to cover all of the plan's benefit liabilities.

Once in progress, if the plan's assets cannot cover all benefit liabilities, the plan's administrator must notify the PBGC and stop the termination process. The PBGC can also issue a Notice of Non-compliance that nullifies a proposed termination if it finds that a plan administrator is not following proper procedures. For additional information on standard terminations, see http://www.pbgc.gov/prac/terminations/standard-terminations.html

DISTRESS TERMINATIONS

Under certain circumstances, an employer can voluntarily terminate its pension plan when it does not have enough assets to cover all benefits owed to participants. In these distress terminations, PBGC takes over the plan as a trustee and uses its own assets and any remaining assets in the plan to provide current and future retirees with benefits, up to maximum benefit amounts set by Congress.

These terminations can only occur if the employer (1) files a petition seeking liquidation in bankruptcy; (2) files a petition seeking reorganization in bankruptcy and the bankruptcy court determines that the employer will be unable to reorganize without a plan termination; (3) proves that it cannot continue in business unless the plan is terminated; or (4) proves that the costs of providing pension coverage have become unreasonably burdensome solely as a result of a decline in the number of employees in the plan.

Among other things, an employer proceeding with a distress termination must:

1. elect a proposed termination date;

2. identify which of the four distress tests can be satisfied;

3. issue a Notice of Intent to Terminate to all affected parties at least 60 days but not more than 90 days before the proposed termination date;

4. beginning on the proposed termination date, reduce the benefits of those participants currently being paid to the estimated benefit amounts which will be payable by PBGC;

5. file a Distress Termination Notice with the PBGC on or before the 120th day after the proposed termination; and

6. file participant and benefit information with the PBGC by the later of (1) 120 days after the proposed termination date or (2) 30 days after receipt of the PBGC's determination that the requirements for a distress termination have been satisfied.

If a plan terminates in a distress termination without sufficient assets to pay all benefit liabilities, the contributing sponsor(s) are jointly and severally liable to the PBGC under ERISA for the total amount of the unfunded benefit liabilities. For additional information on distress terminations, see http://www.pbgc.gov/prac/terminations/distress-terminations.html.

INVOLUNTARY TERMINATION

ERISA allows PBGC to terminate a pension plan even if an employer has not initiated a termination. PBGC can take this action if it determines that (1) a pension plan has not met minimum funding requirements, (2) a lump sum payment has been made to a participant who is also a substantial owner of the plan's sponsoring employer, or (3) PBGC will face an unreasonably increased loss if the plan is not terminated. In addition, PBGC must terminate a plan if it finds that a plan's assets are unavailable to pay benefits that are currently due. For more information on involuntary terminations, see http://www.pbgc.gov/prac/terminations/pbgc-initiated-terminations.html.

LH:dy